

Message Text

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ACTION NEA-11

INFO OCT-01 ISO-00 AID-05 TRSE-00 CIAE-00 COME-00
EB-08 FRB-03 INR-10 NSAE-00 ICA-11 XMB-02 OPIC-03
SP-02 LAB-04 SIL-01 OMB-01 NSC-05 SS-15 STR-07
CEA-01 AGRE-00 PA-01 /091 W
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FM AMEMBASSY NEW DELHI
TO SECSTATE WASHDC 1384
INFO AMCONSUL BOMBAY
AMCONSUL MADRAS
AMCONSUL CALCUTTA

LIMITED OFFICIAL USE SECTION 1 OF 2 NEW DELHI 7056

JOINT STATE-AID MESSAGE

PASS AID AND TREASURY

E.O. 11652: NA
TAGS: EAID,IN
SUBJECT: INDIA CONSORTIUM, JUNE 8-9, 1978

REF: A) STATE 109608; B) NEW DELHI 4564

1. SUMMARY. THIS MESSAGE SUPPLEMENTS MISSION COMMENTS
IN REF B ON THE LATEST WORLD BANK REPORT ON THE INDIAN
ECONOMY. WE BELIEVE THAT, IN ADDITION TO FUTURE LEVELS
OF FOREIGN ASSESTANCE TO INDIA DISCUSSED IN REF B, OTHER
MAJOR ISSUES WHICH THE US DELEGATION TO THE CONSORTIUM
MEETING SHOULD ADDRESS CONCERN INDIA'S ABSORPTIVE CAPACITY
AND GOI INDUSTRIAL AND IMPORT POLICIES. END SUMMARY.

2. ABSORPTIVE CAPACITY. THE WORLD BANK REPORT POINTS OUT:
"THE MAJOR PROBLEM OF THE INDIAN ECONOMY DURING THE PAST
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TWO OR THREE YEARS HAS NOT BEEN RESOURCE SHORTAGES. ON
THE CONTRARY, THE ECONOMY HAS BEEN FACED WITH EXCESS
SAVINGS IN RELATION TO DOMESTIC INVESTMENT AND HAS BEEN
UNABLE TO ABSORB THE AVAILABLE RESOURCES." IN DISCUSSING
UNEMPLOYMENT THE REPORT NOTES THAT A REALISTIC ALLOCATION

OF RESOURCES MUST BE ACCOMPANIED BY AN EFFECTIVE

ADMINISTRATIVE FRAMEWORK TO TRANSLATE PLANS INTO ACTUALITY. ACCORDING TO THE REPORT, FOREIGN AID IN THE PIPELINE AMOUNTED TO ALMOST \$4.5 BILLION (MOST OF IT PROJECT ASSISTANCE) AT THE END OF MARCH 1978, AN INCREASE OF APPROXIMATELY \$1 BILLION IN 1977-78. IT WARNED THAT "ACTUAL ABSORPTION OF AID MAY LAG BEHIND AID COMMITMENTS FOR A FEW YEARS."

3. COMMENT. INDIA'S FUTURE CAPACITY TO IMPLEMENT AND INCREASING NUMBER OF DEVELOPMENT PROJECTS FUNDED BY EITHER DOMESTIC RESOURCES OR FOREIGN ASSISTANCE IS A COMPLEX ISSUE. THE GOI WAS UNABLE TO SPEND ALL ITS DEVELOPMENT FUNDS ALLOCATED IN THE 1977-78 ANNUAL PLAN. THE JANATA PARTY'S GREATER EMPHASIS ON AGRICULTURE, RURAL DEVELOPMENT AND THE SMALL SCALE SECTOR IMPLY A GREATER DEGREE OF ADMINISTRATIVE AND MANAGERIAL CAPABILITY TO CARRY OUT THESE OBJECTIVES. MUCH OF THEIR IMPLEMENTATION DEPENDS ON THE STATES. SEVERAL OF THE MOST BACKWARD STATES, SUCH AS UP AND BIHAR, WHERE RURAL NEEDS ARE GREATEST, ARE PRESENTLY FACED WITH INCOMPETENT POLITICAL LEADERSHIP IN ADDITION TO GENERALLY INADEQUATE ECONOMIC INFRASTRUCTURE AND ADMINISTRATIVE CAPACITY. IN MANY INSTANCES THERE IS LACK OF WELL-CONCEIVED PROJECTS AND/OR GOOD ADMINISTRATORS IN RURAL AREAS. POLITICAL, SOCIAL AND INSTITUTIONAL BARRIERS ARE A FACT OF LIFE IN MOST OF RURAL INDIA. WITHIN THIS ENVIRONMENT THAT IS RESISTANT TO CHANGE, THERE ARE A LIMITED OFFICIAL USE

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HANDFUL OF LARGE AND CAPABLE NATIONAL INSTITUTIONS AND PROGRESSIVE STATE GOVERNMENTS WITH PROVEN EFFECTIVENESS IN FOSTERING RURAL DEVELOPMENT. THEY ARE THE CURRENT CHANNELS FOR MUCH OF CONSORTIUM ASSISTANCE AND ARE DUE FOR AN INCREASED SHARE. THERE ARE LIMITS TO THEIR EXPANSION, HOWEVER, AND IT IS LIKELY THAT AID DISBURSEMENTS WILL BE SLOWER THAN WE WOULD LIKE. AN IMPORTANT QUESTION WOULD BE WHAT NEW, REVIVED OR STRENGTHENED INSTITUTIONAL MECHANISMS ARE PART OF GOI PLANS TO CARRY OUT ITS AMBITIOUS RURAL DEVELOPMENT PLANS AND THEREBY INCREASE THE COUNTRY'S ABSORPTIVE CAPACITY. END COMMENT.

4. GOI INDUSTRIAL POLICIES. THE REPORT DISCUSSES THE PROBLEMS OF THE INDUSTRIAL SECTOR, INCLUDING SLOW GROWTH OF AGRO-BASED INDUSTRIES THAT ACCOUNT FOR A LARGE PROPORTION OF INDUSTRIAL VALUE ADDED AND EMPLOYMENT, INEFFICIENT FIRMS, A RISING CAPITAL-OUTPUT RATIO, UNCERTAINTY ABOUT GOI POLICIES AND DECLINING PRIVATE INVESTMENT. THE BANK NOTES THAT THE JANATA'S NEW INDUSTRIAL POLICY CONTINUES TO EMPHASIZE GOVERNMENT

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JOINT STATE-AID MESSAGE

PASS AID AND TREASURY

CONTROLS AND LICENSING AS THE MAIN INSTRUMENTS FOR
ACHIEVING ITS OBJECTIVES. IT IS "UNFORTUNATE" THAT THE
"GENERAL APPROACH OF THE NEW POLICY AGAIN APPEARS TO BE
PROHIBITIVE RATHER THAN PROMOTIONAL". ACCORDING TO THE
REPORT, TOO HIGH RATES OF CORPORATE TAXATION HAVE
CONTRIBUTED TO LOW PROFITS AND INSUFFICIENT INVESTMENT.
IT SAYS THAT THE FUTURE ROLE OF THE PRIVATE SECTOR HAS
BEEN LEFT "SOMEWHAT UNDEFINED" BY THE JANATA GOVERNMENT.
IT ALSO WARNS AGAINST INDISCRIMINATE PROMOTION OF SMALL
SCALE INDUSTRIES, NOT ONLY BECAUSE SOME SMALL MANUFACTURING
UNITS ARE CAPITAL INTENSIVE IN NATURE AND WILL NOT CREATE
JOB OPPORTUNITIES, BUT ALSO BECAUSE QUESTIONS OF EFFICIENCY
AND PRODUCT QUALITY MUST BE TAKEN INTO ACCOUNT. THE BANK
RECOMMENDS A COMPREHENSIVE OVERHAUL OF THE INDUSTRIAL
REGULATION SYSTEM SO THAT THE PRIVATE SECTOR WILL HAVE
A CLEAR SYSTEM OF GROUND RULES. WITH REDUCED UNCERTAINTY,
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PRIVATE FIRMS WILL HOPEFULLY STEP UP THEIR INVESTMENT AND

THUS CONTRIBUTE TO FASTER INDUSTRIAL GROWTH.

5. COMMENT. WE BELIEVE MUCH OF THE BANK'S CRITICISM OF GOI INDUSTRIAL POLICIES IS VALID. WHILE THERE HAS BEEN SOME LIBERALIZATION (E.G. OF LICENSING CONTROLS), THE JANATA'S NATIONAL EXECUTIVE HAS RECENTLY RECOMMENDED THAT CERTAIN LARGE INDUSTRIAL FIRMS BE BROUGHT DIRECTLY UNDER PUBLIC CONTROL (NEW DELHI 6649). ATTACKS ON CONCENTRATION OF ECONOMIC POWER OR "INDUSTRIAL FEUDALISM" ARE LIKELY TO DISCOURAGE NEW INVESTMENT BY PRIVATE FIRMS. THE JANATA'S ATTITUDE TOWARD THE PRIVATE SECTOR REMAINS AMBIGUOUS, A REFLECTION OF THE DISPARATE NATURE OF THE RULING COALITION. IN ADDITION, THE GOI EMPHASIS ON SMALL SCALE UNITS MEANS THAT GREATER ADMINISTRATIVE CAPACITY IS NEEDED TO HELP DEVELOP AND SERVICE THESE FIRMS. END COMMENT.

6. GOI IMPORT POLICY. THE REPORT BRIEFLY DESCRIBES THE LIBERALIZED IMPORT POLICY FOR 1978-79. THE NEW POLICY IS GENERALLY WELCOMED AS A STEP IN THE RIGHT DIRECTION TO PERMIT AN INCREASE IN IMPORTS OF CAPITAL GOODS AND INDUSTRIAL INPUTS. HOWEVER, THE BANK RECOMMENDS A SELECTIVE REDUCTION IN IMPORT DUTIES, EVEN OF ITEMS PRODUCED DOMESTICALLY, EITHER BECAUSE THE DOMESTIC INDUSTRY HAS OUTGROWN ITS NEED FOR PROTECTION OR BECAUSE OF THE ADDITIONAL PROTECTION TO LOCAL FIRMS FROM THE EFFECTIVE DEPRECIATION OF THE RUPEE IN RECENT YEARS. LOWER IMPORT DUTIES WOULD HELP REDUCE INDUSTRIAL INPUT COSTS AND MAKE DOMESTIC FIRMS MORE COMPETITIVE.

7. COMMENT. WE AGREE THAT THE NEW IMPORT POLICY IS A STEP IN THE RIGHT DIRECTION, BUT SHOULD BE LIBERALIZED LIMITED OFFICIAL USE

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FURTHER IN VIEW OF INDIA'S VERY FAVORABLE BALANCE OF PAYMENTS SITUATION AND RECORD FOREIGN EXCHANGE RESERVES. DESPITE THE IMPORT LIBERALIZATION, WE HAVE NOT YET SEEN ANY SIGNIFICANT SIGNS OF A PICK UP IN PRIVATE INVESTMENT. IT IS UNLIKELY, THEREFORE, THAT TOTAL IMPORTS IN 1978-79 WILL BE AS MUCH (\$7.6 BILLION) AS THE BANK PROJECTS. ALSO, WE BELIEVE THAT THE BANK'S PROJECTION OF ANNUAL GROWTH IN VOLUME OF IMPORTS DURING 1978-83 (14 PERCENT) IS TOO HIGH. WE ARE LESS OPTIMISTIC THAN THE BANK ABOUT THE ABILITY OF BOTH THE PRIVATE AND PUBLIC SECTORS TO IMPORT GOODS AT SUCH A RAPID RATE. CONCOMITANTLY, WE NOW THINK THAT THE BANK'S PROJECTION OF FOREIGN EXCHANGE RESERVES OF \$10.2 BILLION BY THE END OF THE DRAFT PLAN PERIOD IN MARCH 1983 IS TOO CONSERVATIVE. THE GOI WOULD LIKE TO USE FX RESERVES FOR DEVELOPMENT PURPOSES BUT SO FAR HAS BEEN UNABLE TO DO SO EFFECTIVELY. THESE THOUGHTS LEAD

US BACK AGAIN FULL CIRCLE TO THE ISSUE OF INDIA'S FUTURE
ABSORPTIVE CAPACITY.
GOHEEN

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